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Fifty years in Wall Street

Actually, the headline alludes to the 50th anniversary of the start of my first job on Wall Street (this is your editor speaking). The occasion must call for something or other, the *Grant's* editorial councils decided—perhaps a rumination on the origin and evolution of modern finance. Let's see what the light of a half-century's worth of birthday candles can shed on the past, the present and—if possible—the future.

I was 20 in 1967 when I took my place at the corporate-bond desk of McDonnell & Co., a smallish, respectable New York Stock Exchange member firm. My credentials consisted of a high school diploma, one semester of college and two years' enlisted service aboard the USS *Hornet*.

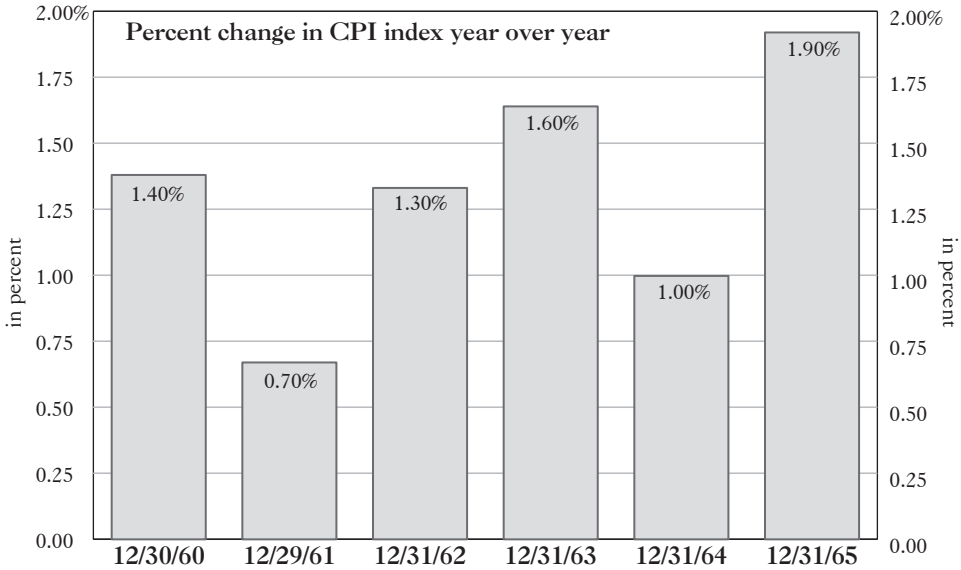
I was a clerk. I answered the phones and relayed buy and sell orders to over-the-counter bond dealers or to the floor of the New York Stock Exchange. Everything there was to know about corporate bonds was printed on S&P tear sheets or between the covers of a Moody's *Manual* or in the pages of *The Wall Street Journal* or *New York Times*. Bells rang on the Dow Jones ticker to signal breaking news. Equity prices chugged by on a wall-mounted Trans-Lux ticker. Buy and sell orders moved within the firm via pneumatic tube. Suit and tie was the corporate uniform, and you worked with your jacket on. Computers worked with punch cards. Technophiles carried slide rules.

I sat among institutional salesmen who earned $100,000 a year and up (I made a little more than $100 a week). The more they sold of the firm's syndicated bond offerings and IPOs, the more they earned. The salesmen met their clients for lunch or for drinks (sometimes both at the same time), and they called them on the phone. An institutional salesman spent most of his time on the phone. It was a special kind of value-adding service to get to the office early and call clients with news you had read in the paper.

Bloomberg terminals, higher bond math, bespoke market indices, quantitative-risk models, TRACE, Greek words, podcasts, downloadable SEC filings, "forward guidance," big data, collaborative networks, earnings-call transcripts and other such trappings of today's information culture were unavailable and (for the most part) unimagined. "Price down, yield up and vice versa" was the summation of bond wisdom, and even a newbie could understand it. Structured finance loomed over the digital horizon—Ginnie Mae guaranteed the first mortgage pass-through securities in 1968. Much of what passes for plain-vanilla rate-driven trading these days would have been unintelligible to the practitioners of 50 years ago. Thus, for instance, there were no payer swaptions on 10-year euro rates because (a) there were no swaptions and (b) there was no euro. Nor was there today's computing power. Without it, how great a swath of our 21st-century financial assets would be impossible to deal in, to value or to administer? We kept it simple out of necessity 50 years ago.

Wall Street was still a physical place. It had to be because wealth still took a physical form. You could touch it. Gold, the underlying money into which the dollar was convertible for certain privileged parties, was as tangible as it could be.

When less inflation was more



source: The Bloomberg

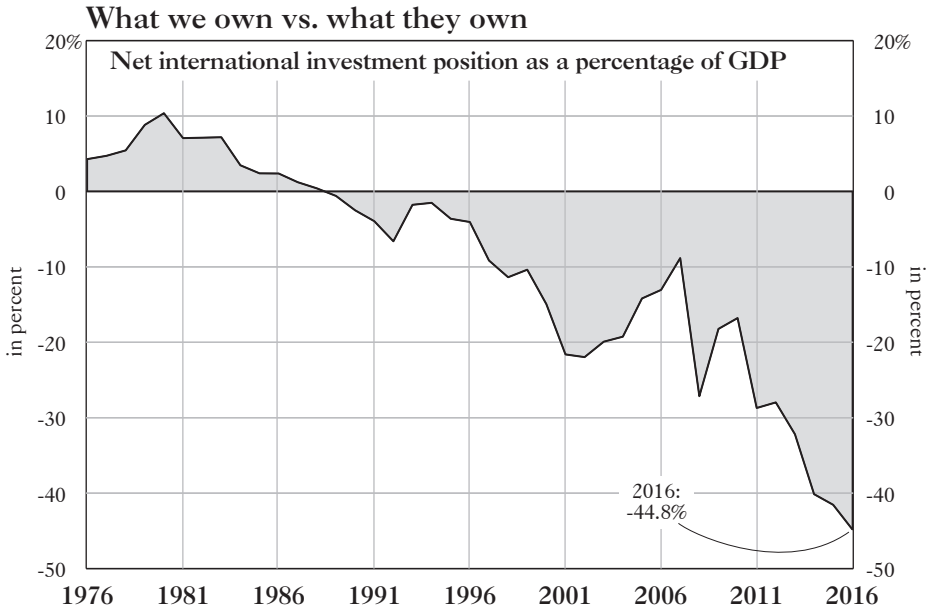
For the efficient transfer of checks and securities, New York Stock Exchange member firms huddled together in the vicinity of the Exchange at the corner of Broad and Wall. McDonnell & Co. made its offices nearby at 120 Broadway, where the men's room stalls were equipped with brackets on which to rest one's lit cigar. You stood in line on Fridays to deposit your paycheck at the Marine Midland Bank, just across Cedar Street.

Bond prices were falling and stock prices rising in the summer of 1967. By Labor Day, long-dated governments would fetch 5%, investment-grade corporates 6%. These were remarkable yields, the highest of the postwar era. Speculation was on the boil—no less than one-third of American Stock Exchange-listed shares had doubled in price since the start of the year. It was a lovely bull market, but NYSE volume of as little as 15 million shares a day taxed the stock market's frail clearing infrastructure.

I came of age on Wall Street when the chairman of the Federal Reserve Board—he was William McChesney Martin—condemned even trace amounts of inflation as an economic and moral evil. In the interval of 1960–65, there was not one year in which the CPI registered a year-over-year rise of as much as 2%. The bond market was reciprocally, eerily still. (It was "the most unusual period of stability in the postwar period," said Sidney Homer, the interest-rate historian.)

Nowadays, it's the ostensible paucity of inflation that the central bankers denounce. Just the other day, Mario Draghi uttered the words "subpar inflation" in referring to the 1.3% year-over-year increase in eurozone prices. Perhaps what he meant was "subpar inflation in the context of four recently failed (or bailed-out) European banks and an effectively unserviceable burden of sovereign European debt." Anyway, he did say "subpar inflation."

In 1961, a year in which the CPI registered a year-over-year rise of 0.70%, Martin decried the "budgetary and monetary practices that can undermine the value of the dollar." Lest we romanticize the Fed under Martin's leadership, I will record the fact that the Fed boosted its holdings of government securities by 10.9% in 1967. This aggressive act of debt monetization occurred at a time when the economy was growing (GDP by 2.7%), the federal deficit was mounting and the Vietnam War was hotting up. Perhaps it



source: U.S. Bureau of Economic Analysis

was no coincidence that the CPI in 1967 jumped by 3%, the second-highest rise in a decade (behind 3.5% in 1966).

Even so, Martin talked like the central banker who was prepared to take away the punch bowl. It is impossible to imagine him carrying out the policies that Ben Bernanke implemented to lift stock and bond prices in the name of stimulating "aggregate demand." Martin, though he took graduate courses in economics at Columbia University, was no theoretical economist. His healthy (say I) suspicion of modern economic theory found expression in his refusal to fill the research department with doctors of economics, though they quickly colonized the Fed after Martin's departure in 1970.

On the occasion of the celebration of the 175th anniversary of the New York Stock Exchange—this was in May 1967—Martin told 700 business and banking leaders gathered in Lincoln Center that the time had come for stricter margin requirements. A past president of the Big Board, Martin said that the current bull market reminded him of the pool operations of the 1920s. The 30 stocks of the Dow Jones Industrial Average then changed hands at the not-overstretched average of 15.4 times trailing 1966 net income, according to *Barron's*, which cost 35 cents on the newsstand.

The quality of fixedness was a feature of American financial and monetary arrangements a half-century ago. Depression-era banking regulations, including Regulation Q, under which the Fed set maximum bank-deposit rates, were still in force. The Stock Exchange set minimum commission rates. Forex rates were likewise fixed. Foreign central banks could exchange their dollars for gold, and vice versa, at the statutory rate of $35 to the ounce. (American citizens had no such privilege; in America, the barbarous relic was still contraband.)

What even seasoned bond men could not have predicted fifty years ago stands in the record books today. The bond bear market which began in 1946 and persisted till 1981 lifted those seemingly lofty 5% long-government yields all the way to 15%. If the bond traders with whom I rubbed elbows in 1967 were speculating about the eventual likelihood of a 15%-yielding, 30-year Treasury bond, I don't remember it. Probably, they would have thought it was a physical impossibility (how could the country function at such a rate of interest?). Similarly, at the 1981 bond-market nadir: Who were the clairvoyants who anticipated that, in 35 short years, i.e., by the summer of 2016, as much as $13 trillion of European and Japanese sovereign debt would be priced to yield less than zero? A wild imagination must be the successful investor's most underrated item of intellectual equipment.

A slightly less strenuous feat of foreknowledge was required of a monetary prophet. America had been losing gold to its foreign creditors since the late 1950s. The outflow indicated that there were too many dollars circulating in the world. Surely, then, America should spend less? Successive administrations rejected that suggestion in favor of palli-

atives—an international pool operation to tamp down the unwanted rise in the free-market gold price above the lawful $35-per-ounce price; "Operation Twist" to lift short-term dollar interest rates in relation to longer-term rates (and so to entice foreigners to hold dollars, rather than metal); "Operation Goldfinger," a secret government project to extract gold from seawater meteorites, plants and what have you (the 20th-century alchemists succeeded no better than the medieval ones did). Those gimmicks coming to naught, the Johnson administration in 1964 ordered capital controls in the shape of a so-called interest-equalization tax. Neither did that makeshift succeed.

If, on the surface, there was no inflation, price pressures were nonetheless building beneath the still waters. In 1966, market interest rates spiked above the Reg Q deposit-rate ceilings. Americans responded with a new kind of bank run, though something very like an old-fashioned money panic ensued. This was when "disintermediation" entered the Wall Street lexicon.

I doubt that my betters at McDonnell & Co. were the first to arrive at the conclusion that the Vietnam War and the Great Society (Lyndon Johnson's domestic spend-a-thon) were incompatible with a gold dollar and low inflation. Robert M. Bleiberg, the editor of *Barron's* who would later become my mentor when I joined the staff of that publication in 1975, did see things just that way.

A half-century ago, *Barron's* led with the editorial commentary, a little like *Grant's* today. The page-one headline in the issue dated July 24, 1967 ran as follows: "Good as Gold? The Treasury Has a Lot to Learn About Money." The piece quoted Miroslav Kriz, author of "Gold: Barbarous Relic or Useful Instrument?," an essay which Princeton University—of all the institutions of higher learning—had just published.

Kriz had worked for the League of Nations and the Federal Reserve before alighting on the economics staff of Citibank. He looked at America's payments predicament neither as a political adviser to Lyndon Johnson nor as a helpmeet to Citibank's bond salesmen, but through the eyes of a creditor to the Treasury. So his view was decidedly pro-gold, or, rather, pro the discipline that a gold standard required of governments and citizens who might prefer to be undisciplined. The editorial closed with Kriz's words: "At times the shoe may pinch, particularly if nations indulge in inflation. But in that event something *ought* to pinch to communicate a sense of harsh reality to the need for a nation to keep its economic and financial house in order."

I left McDonnell & Co. in August 1967 to return to college (this time I stayed). McDonnell closed its doors in 1970, having choked to death, at the age of 65, on its own uncleared trades. It was one of many member firms to succumb to the paperwork crisis of the late 1960s. By the time I returned to the workforce—now on the staff of *The Baltimore Sun*—Bretton Woods was kaput, the Great Inflation was under way and the generation-length bear bond market was getting up a head of steam.

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Of all the emotions you can bring to the office, nostalgia must be the least repaying. I confess that I'm more than a little nostalgic for the Wall Street in which I came of age—if I weren't, *Grant's* wouldn't look like the old *Barron's*, nor would the publisher of *Grant's* continue to make his editorial offices in lower Manhattan, where a man in a suit and a bow tie stands out like a time traveler from 1967 (tourists, who predominate Downtown these days, dress for comfort, only). You can find Evan Lorenz and Delzoria Coleman and John McCarthy and Eric Whitehead and Harrison Waddill and Phil Grant and me on the sixth floor of 2 Wall Street, directly across from the Stock Exchange, the building perhaps best known today for housing a CNBC set. Our offices overlook the green Trinity churchyard, in which I like to take a late afternoon stroll. I draw particular inspiration from the inscriptions on the headstones of three permanent residents of the burial ground: Alexander Hamilton, Washington's secretary of the Treasury; Albert Gallatin, Jefferson's secretary of the Treasury; and Capt. James Lawrence, USN ("Don't give up the ship!").

Besides the neighborhood and the people who used to work in it, I am nostalgic for certain departed institutions, ideas and ideals. I miss fixed exchange rates, the idea of a convertible currency and the ideal of personal responsibility for financial outcomes. As to this last point, the Wall Street firms of 50 years ago were organized as general partnerships. They next became limited-liability corporations. And they next—not a few of them, around the year 2008—became too big to fail. Whose idea of progress is this?

Such stability as exists on Wall Street comes courtesy of age-old behavioral patterns. Perhaps a buy-low, sell-high gene is standard human issue. The old windbag Henry Clews (1834–1923), author of the memoir *Fifty Years in Wall Street* (yes, I stole the title for our headline), devotes his third chapter to the ever popular topic of "How to Make Money in Wall Street." It's simple, says Clews: Wait for a selling squall, then buy. Writing around the time of the Panic of 1907, he asserted that the market presented at least one such opportunity every year. This was of course before the advent of monthly, weekly or even daily investment-performance monitoring; not many active managers (that dwindling breed!) are in a position to do nothing when nothing is the thing to do. Then, too, the Federal Reserve, nonexistent when Clews published, nowadays seemingly does its all to prevent securities prices from entering the value zone.

Markets are about the future, and the future is about change. "What's different?" or—better still—"what's going to be different?" are the questions that lead, however circuitously, to the promised land.

What's different in comparison to 1967? What isn't different? Fifty years ago, the Soviet Union was still in business, Bill Gates was 11 years old, Jeff Bezos was three and Mark Zuckerberg was minus 17. The baby boomers were coming into their economic majority. The price tag of the Great Society was yet uncalculated.

Fifty years ago, what we call private equity was a cottage industry. Leveraged share repurchases would have been heretical if anyone had tried them (Henry Singleton, visionary chief of Teledyne, pioneered the art of buying cheap stock, and issuing dear stock, in the 1970s; *BusinessWeek* condemned him for it in a 1982 cover story). In 1967, volatility was scarcely a concept, let alone an asset class. Henry Clews said that the purpose of Wall Street was to finance America's growth. There's still a bit of that kind of business to be done today, but the purpose of finance seems more and more to be finance itself.

Financial orthodoxy was on its way out in 1967—Miroslav Kriz was yesterday's number even a half-century ago—though you can never be dogmatic about

the future. Everything has its season in markets, ideas included. Magical thinking, let us call today's received monetary doctrine, may itself be on the way out. Perhaps it will meet old-time religion in the cyclical revolving doors.

"The shoe" ought to pinch, said Kriz, alluding to the constraints that a gold standard imposes on a high-living nation state. Unconstrained, America has run up persistent deficits: on current account, in the federal budget and in net foreign investment. Incurring debt and creating credit in the absence of gold-like discipline turns out to resemble a game of tennis played with no net, no baselines and no sidelines. At least, it so resembles that kind of tennis for the privileged issuer of the world's reserve currency.

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All was well, fiscally, until the Great Society, relates Jeffrey Miron, director of economic studies at the Cato Institute and director of undergraduate studies in the Harvard economics department. It was guns and butter *and* Medicare *and* Medicaid *and* (later) the Affordable Care Act that—by Miron's calculations—pushed this country into a $120 trillion hole. Miron arrives at that calculation by comparing the net present value of what the government expects to spend versus the net present value of what the government expects to take in, over the next 75 years. It's a measure of today's debt plus the present value of the debt that will accumulate if federal policies remain the same (for details, see *Grant's*, April 22, 2016).

Magical thinking in the monetary and fiscal realm I judge to pose the greatest macroeconomic risk to American prosperity. A few days ago, Business Insider published a bullish story on the crypto-currencies. The analyst whom the story quoted described a future in which the likes of bitcoin and ethereum will sweep gold from the field and challenge the market share of the dollar's fiat competitors. And just imagine, the story concluded, if the central banks start buying those cryptos—according to the analyst, they have already "looked into the possibility."

The vision of central banks' buying ethereum with fiat ether is one that, at first, seems outlandish. On second blush—in this age of wild-haired monetary experimentation—it seems almost predestined to occur, a reductio ad absurdum of the stature of negative nominal sovereign-bond yields.

That is the risk. And that, journalistically speaking, is the opportunity. *Grant's* anticipates a new cycle of rising interest rates, falling share prices and recalibrated monetary thought (timing uncertain). We fairly champ at the bit for the next 50 years.

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